SURFACE TRANSPORTATION BOARD REVISES ITS COST OF CAPITAL METHODOLOGY

Today the Surface Transportation Board issued its final decision revising its method for calculating the railroad industry's cost of capital. The Board adopts a simple average of a Capital Asset Pricing model (CAPM) and a multi-stage Discounted Cash Flow (DCF) model to calculate the cost of equity—one component of the cost of capital. The Board concludes that this methodology will yield a more precise determination than relying on CAPM alone.

In January 2008, the Board replaced its single-stage DCF model with a CAPM model. During the CAPM rulemaking process, several parties urged the Board to use a multi-stage DCF model in conjunction with CAPM to obtain a more stable and precise estimate of the cost of equity. The record in that rulemaking, however, did not provide a suitable multi-stage DCF model for the Board to consider. In February 2008, the Board began to explore whether it could further improve its methodology for estimating the cost of equity by incorporating a multi-stage DCF model. Today's decision, adopting a simple average of CAPM and a multi-stage DCF to measure the cost of equity, concludes this effort.

The Board uses the cost of capital figure in evaluating the adequacy of individual railroads' revenues each year. The figure is also used in maximum rate cases, feeder-line applications, rail line abandonments, trackage rights cases, rail-merger reviews, and more generally in the Board's Uniform Rail Costing System. The Board will use this new approach to estimate the railroad industry's 2008 cost of capital.

Today's decision, issued in the proceeding entitled Use of a Multi-Stage Discounted Cash Flow Model In Determining the Railroad Industry's Cost of Capital, STB Ex Parte No. 664 (Sub-No. 1), is available for viewing and downloading via the Board's Web site at http://www.stb.dot.gov under "E-Library," then under "Decisions & Notices," beneath the date "1/28/09."

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